

**Illinois Department of Revenue  
Regulations**

<b>Title 86 Part 100 Section 100.3010 Business and Nonbusiness Income (IITA Section 301)</b>
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**TITLE 86: REVENUE**

**PART 100**

**INCOME TAX**

**Section 100.3010 Business and Nonbusiness Income (IITA Section 301)**

- a) In general. For purposes of administration of Article 3 of the Illinois Income Tax Act:
  - 1) For transactions and activities occurring prior to July 30, 2004 (the effective date of Public Act 93-0840), business income is *income arising from transactions and activity in the regular course of a trade or business and includes income from tangible and intangible property constituting integral parts of a person's regular trade or business operations*. (See IITA Section 1501(a)(1), prior to amendment by Public Act 93-0840.) The classification of income by the labels occasionally used, such as manufacturing income, sales income, interest, dividends, rents, royalties, gains, and operating income, is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of trade or business operations. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity that are the elements of a particular trade or business. In general, all transactions and activity that are dependent upon or contribute to the operations of the economic enterprise as a whole will be transactions and activity arising in the regular course of a trade or business.
  - 2) For transactions or activities occurring on or after July 30, 2004, business income is *all income that may be treated as apportionable business income under the Constitution of the United States*. (See IITA Section 1501(a)(1), after amendment by Public Act 93-0840.) By adopting this definition, the General Assembly overruled the decisions in the following cases:
    - A) Blessing/White, Inc. v. Zehnder, 329 Ill. App. 3d 714 (Third Div. 2002) and American States Insurance Co. v. Hamer, 352 Ill. App. 3d 521 (First Div. 2004), which held that the gain on a sale of an entire line of business was nonbusiness income. This "liquidating sale" exclusion from business income was based on the courts' construction of the statutory definition of business income prior to the enactment of Public Act 93-0840, and not on any principle of the Constitution of the United States.
    - B) Hercules, Inc. v. Zehnder, 324 Ill. App. 3d 329 (First Div. 2001), which held that gain realized on the sale of the taxpayer's stock in a subsidiary

corporation that it had received in exchange for the contribution of assets used in its business was not business income. The taxpayer's basis in its stock was determined by its basis in the assets exchanged, so that the gain realized on the sale was attributable, at least in part, to its use of those assets in its business before the exchange. Accordingly, the investment that produced the gain had an operational function related to that business, and is subject to apportionment under *Allied-Signal v. Director*, 504 US 768 (1992). In addition, the court's holding that the taxpayer was not engaged in a unitary business with the subsidiary was based in part on the fact that the taxpayer did not meet the statutory "common ownership" requirement in IITA Section 1501(a)(27), which provides that a corporation must be owned more than 50% in order to be engaged in a unitary business. There is no such requirement in the Constitution of the United States, and a unitary business may exist with less than 50% common ownership. See *In re Panhandle Eastern Pipe Line Co.*, 39 P.3d 21 (Ks. 2002) and *True v. Heitkamp*, 470 NW2d 582 (N.D. 1991). Accordingly, a taxpayer may be engaged in a unitary business with a subsidiary in which it holds only a minority interest, so that the gain or loss realized on the sale of its stock in the subsidiary is subject to apportionment under *Allied-Signal v. Director*, 504 US 768 (1992).

3) For all taxable years:

- A) Business income is *net of the deductions allocable thereto and does not include compensation or the deductions allocable thereto* (IITA Section 1501(a)(1)).
- B) *Nonbusiness income means all income other than business income or compensation* (IITA Section 1501(a)(13)).
- C) A person's income is business income unless clearly classifiable as nonbusiness income.

b) Two or more businesses of a single person

- 1) A person may have more than one "trade or business". In such cases, it is necessary to determine the business income attributable to each separate trade or business. In the case of a person other than a resident, the income of each business is then apportioned by a formula that takes into consideration the instate and outstate factors relating to the trade or business the income of which is being apportioned.
- 2) Example: The person is a corporation with three operating divisions. One division is engaged in manufacturing aerospace items for the federal government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this State as well as in other states. In this case, it is fair to conclude that the corporation is engaged in three separate "trades or businesses". Accordingly, the amount of business income attributable to the corporation's trade or business activities in this State is determined by applying an apportionment formula to the business income of each business.

3) The determination of whether the activities of the person constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the person will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operations of the person as a whole. The following factors are considered to be good indicia of a single trade or business, and the presence of any one of these factors creates a strong indication that the activities of the person constitute a single trade or business.

A) Same type of business. A person is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a person that operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

B) Steps in a vertical process. A person is almost always engaged in a single trade or business when its various divisions or segments are engaged in a vertically structured enterprise. For example, a person that explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the person's executive offices.

C) Strong centralized management. A person that might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for functions such as financing, advertising, research or purchasing. Thus, some corporations may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices that perform for the divisions the normal matters that a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising or financing. Note in this connection that neither the existence of central management authority, nor the exercise of that authority over any particular function (through centralized departments or offices), is determinative in itself; the entire operations of the person must be examined in order to determine whether or not strong centralized management absent other unitary indicia as described in this subsection (b) (i.e., same type of business or steps in a vertical process) justifies a conclusion that the activities of the person constitute a single trade or business. Both elements of strong centralized management, i.e., strong central management authority and the exercise of that authority through centralized departments or offices, must exist in order to justify a conclusion that the operations of seemingly separate divisions are significantly integrated so as to constitute a single trade or business.

c) Items referred to in IITA Section 303 and unspecified items under IITA Section 301(c)(2)

- 1) In general. IITA Section 303 provides rules for the allocation by persons other than residents of Illinois of any item of capital gain or loss, and any item of income from rents or royalties from real or tangible personal property, interest, dividends, and patent or copyright royalties, and prizes awarded under the Illinois Lottery Law [20 ILCS 1605], together with any item of deduction directly allocable to that income, to the extent the item constitutes nonbusiness income. In addition, IITA Section 301(c)(2) provides rules for the allocation by these persons of unspecified items of nonbusiness income. Any item may, in a given case, constitute either business income or nonbusiness income depending on all the facts and circumstances. The following are rules and examples for determining whether particular income is business or nonbusiness income. (The examples used throughout these regulations are illustrative only and do not purport to set forth all pertinent facts.)
- 2) Rents from real and tangible personal property. Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the person's trade or business or is attendant to it and is includable in the property factor under Section 100.3350.
  - A) Example A: A corporation operates a multistate car rental business. The income from car rentals is business income.
  - B) Example B: A corporation is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earth moving vehicles. The corporation makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business income.
  - C) Example C: A corporation operates a multistate chain of men's clothing stores. The corporation purchases a five-story office building for use in connection with its trade or business. It uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are leased to others. The rental of the two floors is attendant to the operation of the corporation's trade or business. The rental income is business income.
  - D) Example D: A corporation operates a multistate chain of grocery stores. As an investment, it uses surplus funds to purchase an office building in another state, leasing the entire building to others. The rental is not attendant to, but rather is separate from, the operation of the grocery store trade or business. The net rental income is nonbusiness income.
  - E) Example E: A corporation operates a multistate chain of men's clothing stores. The corporation invests in a 20-story office building and uses the street floor as one of its retail stores and second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the 18 floors is not attendant to, but rather is separate from, the operation of the corporation's trade or business. The net rental income is nonbusiness income.
  - F) Example F: A corporation constructed a plant for use in its multistate

manufacturing business and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the corporation until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business income.

- 3) Gains or losses from sales of assets. Gain or loss from the sale, exchange or other disposition of real or tangible personal property constitutes business income if the property, while owned by the person, was used in its trade or business. However, if such property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. See Section 100.3350.
  - A) Example A: In conducting its multistate manufacturing business, a corporation systematically replaces automobiles, machines, and other equipment used in the business. The gains or losses resulting from those sales constitute business income.
  - B) Example B: A corporation constructed a plant for use in its multistate manufacturing business and 20 years later sold the property at a gain while it was in operation by the corporation. The gain is business income.
  - C) Example C: Same as subsection (c)(3)(B) except that the plant was closed and put up for sale but was not in fact sold until a buyer was found 18 months later. The gain is business income.
  - D) Example D: Same as subsection (c)(3)(C) except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business income.
- 4) Interest. Interest income is business income where the intangible with respect to which the interest was received, is held or was created in the regular course of the person's trade or business operations or where the purpose for acquiring or holding the intangible is related or attendant to such trade or business operations.
  - A) Example A: A corporation operates a multistate chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business income.
  - B) Example B: A corporation conducts a multistate manufacturing business. During the year the taxpayer receives a federal income tax refund and collects a judgment against a debtor of the business. Both the tax refund and the judgment bore interest. The interest income is business income.
  - C) Example C: A corporation is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the corporation maintains special accounts to cover items such as workers' compensation claims, rain and storm damage, machinery replacement, etc. The moneys

in those accounts are invested at interest. Similarly, the corporation temporarily invests funds intended for payment of federal, state and local tax obligations. The interest income is business income.

- D) Example D: A corporation is engaged in a multistate money order and traveler's check business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the corporation earns interest income by the investment of the funds pending their redemption. The interest income is business income.
  - E) Example E: A corporation is engaged in a multistate manufacturing and selling business. The corporation usually has working capital and extra cash totaling \$200,000 that it regularly invests in short-term interest bearing securities. The interest income is business income.
- 5) Dividends. Dividends are business income where the stock with respect to which the dividends are received, is held or was acquired in the regular course of the person's trade or business operations or where the purpose for acquiring or holding the stock is related or attendant to such trade or business operations.
- A) Example A: A corporation operates a multistate chain of stock brokerage houses. During the year the corporation receives dividends on stock it owns. The dividends are business income.
  - B) Example B: A corporation is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the corporation maintains special accounts to cover items such as workers' compensation claims, etc. A portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business income.
  - C) Example C: Several unrelated corporations own all of the stock of another corporation whose business operations consist solely of acquiring and processing materials for delivery to the corporate owners of its stock. The corporations acquired the stock in order to obtain a source of supply of materials used in their manufacturing businesses. The dividends are business income.
  - D) Example D: A corporation is engaged in a multistate heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity, the corporation holds various stocks and interest-bearing securities. Both the interest income and any dividends received are business income.
  - E) Example E: A corporation receives dividends from the stock of its subsidiary or affiliate that acts as the marketing agency for products manufactured by the corporation. The dividends are business income.

- F) Example F: A corporation is engaged in a multistate glass manufacturing business. It also holds a portfolio of stock and interest-bearing securities, the acquisition and holding of which are unrelated to the corporation's trade or business operations. The dividends and interest income received are nonbusiness income.
- 6) Patent and copyright royalties. Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received, is held or was created in the regular course of the person's trade or business operations or where the purpose for acquiring or holding the patent or copyright is related or attendant to such trade or business operations.
  - A) Example A: A corporation is engaged in the multistate business of manufacturing and selling industrial chemicals. In connection with that business, the corporation obtained patents on some of its products. The corporation licensed the production of the chemicals in foreign countries in return for which the corporation receives royalties. The royalties received by the taxpayer are business income.
  - B) Example B: A corporation is engaged in the music publishing business and holds copyrights on numerous songs. The corporation acquired the assets of a smaller publishing company, including music copyrights. These acquired copyrights are thereafter used by the corporation in its business. Any royalties received on these copyrights are business income.
  - C) Example C: Same as Example B, except that the acquired company also held the patent on a type of phonograph needle. The corporation does not manufacture or sell phonographs or phonograph equipment and the holding of the patent is unrelated to its publishing business operations. Any royalties received on the patent would be nonbusiness income.
- d) Proration and recapture of deductions
  - 1) Most of a person's allowable deductions will be attributable only to the business income arising from a particular trade or business or to a particular item of nonbusiness income. In some cases, an allowable deduction may be attributable to the business income of more than one trade or business and/or to several items of nonbusiness income.
  - 2) In such cases, the deduction shall be prorated among the trades or businesses and such items of nonbusiness income in a manner that fairly distributes the deduction among the classes of income to which it is attributable. In filing returns with this State, if a person departs from or modifies the manner of prorating any deduction used in returns for prior years, the taxpayer should disclose in the return for the current year the nature and extent of the modification. If the returns or reports filed by a person with all states to which the taxpayer reports under Article IV of the Multistate Tax Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the attribution or proration of any deduction, the person shall disclose in its return to this State the nature and extent of the variance.

- 3) *If in prior years income from an asset or business has been classified as business income and in a later year is demonstrated to be non-business income, then all expenses, without limitation, deducted in such later year and in the 2 immediately-preceding taxable years related to that asset or business that generated the non-business income shall be added back and recaptured as business income in the year of the disposition of the asset or business. Such amount shall be apportioned to Illinois using the greater of the apportionment fraction computed for the business under IITA Section 304 for the taxable year or the average of the apportionment fractions computed for the business under IITA Section 304 for the taxable year and for the 2 immediately preceding taxable years (IITA Section 203(e)(3)).*

e) Definitions

- 1) The term "allocation" refers to the assignment of nonbusiness income to a particular state.
- 2) The term "apportionment" refers to the division of business income between states by the use of a formula containing apportionment factors.
- 3) The term "business activity" refers to the transactions and activity occurring in the regular course of a particular trade or business.
- 4) The term "person" under IITA Section 1501(a)(18) shall be construed to mean and include an individual, trust, estate, partnership, association, firm, company, corporation or fiduciary.
- 5) The term "taxpayer" is defined in IITA Section 1501(a)(24) to mean any person subject to the tax imposed by the Act.
- 6) For a definition of the term "commercial domicile", see Section 100.3210.
- 7) For a definition of the term "resident", see Section 100.3020.
- 8) For a definition of the term "state", see Section 100.3110.
- 9) For a definition of the term "taxable in another state", see Section 100.3200.

(Source: Amended at 32 Ill. Reg. 6055, effective March 25, 2008)